

**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 99-0307**

**Individual Income Tax**

Calendar Years 1995, 1996, and 1997

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**ISSUE(S)**

I. **S Corporation** – Pass through to Shareholder

**Authority:** 45 IAC 3.1-1-66

Taxpayer protests the disallowance of commissions paid to drivers and cash paid out for supplies.

II. **Tax Administration** – Penalty

**Authority:** IC 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

**STATEMENT OF FACTS**

Taxpayer's S-Corporation was audited for calendar years 1995, 1996, and 1997, the result which flowed through to the shareholder. Taxpayer is a one hundred percent (100%) shareholder in an S Corporation that was audited. The audit adjusted for "Cash Paid Out" relating to supplies and driver mileage where no receipts, records, or other proof was provided. The auditor allowed a deduction based on industry standards for driver mileage.

I. **S Corporation Income** – Pass through to Shareholder

**DISCUSSION**

Taxpayer is a shareholder in an S Corporation. Upon audit, an adjustment was made to the

corporation's income tax return, which flowed through to its shareholders.

The adjustment relates to the disallowance of wages and mileage paid over and above the industry average.

Taxpayer states it appropriately maintains adequate contemporaneous daily documentation of the expenses of driver delivery commissions and supplies; and these expenses are ordinary and necessary business expenses of operating pizza carryout and delivery services, which are fully deductible. Taxpayer is correct in its assertion that these expenses are fully deductible, however, taxpayer did not maintain accurate records. The auditor allowed a deduction based on industry averages for the business.

Taxpayer states that the president's wages were included in the twenty-eight percent cost of goods sold that relates only to its drivers and managers. A review of taxpayer's 1040 indicates it reported \$115,948, \$150,725, and \$155,200 for 1995, 1996, and 1997 respectively as wages on which it paid withholding taxes. Taxpayer states the auditor disallowed the shareholder's wages and included it in the twenty-eight percent calculated for its workers. The department agrees that the president's wages have no bearing on its workers' wages.

The hearing officer obtained the S-Corporation Audit for review. The audit indicates that the president's salary was already deducted from the corporation's income. The adjustment stemmed from the department's disallowance of worker wages in the amount reported on the federal income tax return due to taxpayer's failure to keep records. The auditor utilized industry standards upon which to calculate the wages paid to drivers, which in this case amounted to twenty-eight percent (28%) of total sales. The auditor did not disallow the president's wages deducted on the S-Corporation return. The adjustment was simply for wages and mileage on delivery employees for which the taxpayer had no proof except for its ledgers. In other words, taxpayer claimed \$251,347.38, \$336,391.40 and \$388,644.14 respectively for 1995, 1996, and 1997 as driver compensation. The department allowed \$88,534.17, \$153,021.67, and \$193,362.07 respectively for 1995, 1996, and 1997 which is an industry standard. The audit adjusted to the industry standard because the taxpayer had no names, receipts, work summaries, 1099's, or other required documentation to verify that the expenses were valid. Taxpayer explained how tickets (fifty to a book) verify the information. Taxpayer, however, failed to retain the tickets.

### **FINDING**

Taxpayer's protest is denied.

## **II. Tax Administration – Penalty**

### **DISCUSSION**

Taxpayer protests the penalty assessed and feels the returns were filed correctly. Failure to maintain records for verification is considered negligence. Taxpayer has not provided reasonable cause for

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Page #3  
failing to do so.

**FINDING**

Taxpayer's protest is denied.

**CONCLUSION**

Taxpayer's protest is denied for Issues I. and II.

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